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SUBJECT: The Japan Economic Scope--October 25, 2007

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FINANCIAL NEWS

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13. (SBU) Recent Major Economic Indicators  
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In its monthly economic report, the Cabinet Office left its overall outlook unchanged, noting that the economy is recovering, while some weakness has been recently noted.

Submitted to the Cabinet on October 22, the report confirmed that Japan's economy has now expanded for 69 consecutive months, a record postwar economic boom.

However, the report downgraded its assessment of housing investment and private consumption. The Bank of Japan (BOJ)'s report, released on October 11, also kept its core economic assessment unchanged, indicating that the economy is "expanding moderately."

The BOJ said that personal consumption is firm and household income has continued to rise moderately. The BOJ noted that exports have continued to increase, and business investment has also continued to trend upward against the background of high corporate profits. The BOJ expects the economy to continue expanding moderately in the coming months. (FINATT: Shuya Sakurai)

14. (SBU) Public Pension Fund Goes Small Cap for Big Returns  
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In an effort to raise returns through broader holdings, the Government Pension Investment Fund (GPIF), which oversees public pension assets, will allocate 100 billion yen (\$850 million) toward small- and mid-cap stocks at the start of next

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year.

While this sum represents slightly more than a tenth of the 90 trillion yen (\$780 billion) in assets GPIF manages for MHLW, the decision is in line with GPIF's asset reallocation plans to take effect by FY 2009, and could reflect a somewhat more aggressive posture toward risk and return. At present, most of the fund's stock holdings are large-cap issues, with domestic equities accounting for 20 trillion yen (\$175 billion) of the fund's portfolio. GPIF's returns in FY 2006 were down 9.62 percent from FY 2005, at 4.75 percent. (FINATT: Mateo Ayala)

15. (SBU) GOJ's Six Fiscal Projections Point to Consumption Tax Hike  
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On October 17 the Cabinet Office submitted to the Council on Economic and Fiscal Policy a new set of projections for fiscal consolidation for the fiscal 2007-11 period and for the fiscal costs of social security through fiscal year 2025.

The projections indicated the GOJ's present fiscal consolidation target -- achieving a combined central/local government primary surplus by FY11 -- is attainable only under favorable macroeconomic conditions together with a large cut in government spending.

With the exception that all other scenarios project the need for major tax increases by FY11 to achieve the fiscal consolidation target. If these revenue shortfalls are covered solely by an increase in the consumption tax, a hike of approximately 1- to 3-percentage-points would be required. The projections demonstrate that a consumption tax increase from the present relatively low rate of five percent is inevitable.

However, it is still uncertain whether the Fukuda administration will flesh out a tax hike as part of the current tax reform proposals to be compiled by December. Please refer to the attached document for further details on

the six scenarios. (FINATT: Shuya Sakurai)

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TRANSPORTATION  
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16. (SBU) Fuel Cell Cars Hit the Road, but Commercialization is Years Away  
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As part of the METI-sponsored Hydrogen & Fuel Cell Demonstration Project (JHFC) in Yokohama, Japanese automakers and energy companies, along with GM, Daimler, and others, are testing hydrogen fuel cell vehicles (FCVs) under actual road conditions.

A Toyota FCV recently traveled 560 km from Osaka to Tokyo on a single hydrogen tank. JHFC data shows that current FCVs are 50 percent more energy efficient and produce half the "well-to-wheel" CO2 emissions as conventional gasoline vehicles. FCVs are powered by electricity created when hydrogen gas and air combine in the vehicle's fuel cell stack. While the production and transport of hydrogen involve some greenhouse gas emissions, tailpipe emissions consist of just odorless heat and water.

In test drives of two FCVs at the JHFC facility, Embassy officers noted smooth, quiet acceleration and performance comparable to conventional cars. However, Toyota and Nissan officials speaking at JHFC conceded mass production of FCVs remains years away. Click here to access JHFC's website. (ECON: Toby Wolf)

17. (SBU) Kansai International Airport Worries about Losing Japanese Tourists  
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According to Daily Aviation news, Kansai International Airport (KIX) Vice President Tadakuni Hirano is concerned about the decrease in international passengers at KIX. While the total number of passengers has remained relatively steady over the past six years, the number of Japanese passengers traveling on

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international flights though KIX declined 17 percent during the same time period.

Hirano attributes some of this loss to the suspension and reduction of flights to North America. He would like to establish additional North American routes at KIX even if they are served by a third country, but the prospects are currently unclear.

Hirano also said KIX has been hurt by the Haneda-Shanghai flights which started service on September 28. He was disappointed that the Shanghai Airlines reduced KIX flights from ten to seven.

He also said he anticipates negotiations regarding additional routes to China during the next round of air talks between Japan and China. (ECON: Junko Nagahama)

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POSTAL PRIVATIZATION  
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18. (SBU) New Postal Union to be Japan's Largest  
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Creating Japan's largest labor union, the Japan Postal Workers' Union (JPU) and All Japan Postal Labor Union (JPLU or Zen Yusei) officially merged October 22. Opposition to postal privatization led the unions, which had a long history as rivals, to join forces.

The new Japan Postal Group Union (JPGU or "JP Roso") substantially exceeds Japan's next largest union, NTT's, which has a membership of 185,000. JP Roso's new chairman, Yoshikazu

Yamaguchi said during the union's inaugural meeting that the group will aim to increase its membership from 233,000 to 300,000 within two years by recruiting "non-regular" workers in addition to core membership of career employees. JP Roso is affiliated with the Japanese Trade Union Confederation (JTUC-Rengo). (ECON: Ai Kaneko)

19. (SBU) Bill to "Review" Postal Privatization Submitted to the Upper House  
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Three opposition parties -- the Democratic Party of Japan (DPJ), the People's New Party (PNP) and the Social Democratic Party (SDP) -- jointly submitted a bill to the Upper House on October 23 to "review" postal privatization. The bill calls for the freeze of stock sales of the three companies formed on October 1 as part of the privatization: Japan Post Holdings, Yucho Bank, and Kampo Insurance.

The bill is not expected to pass, as a similar anti-postal privatization bill failed in the last Diet session. The DPJ chose to endorse the bill, however, because it created a parliamentary coalition with the PNP, bringing its Upper House coalition Diet member count to 119 -- just three short of an outright majority.

The PNP was formed by Liberal Democratic Party members who were thrown out of the LDP for opposing postal privatization in the summer of 2005. (ECON: Ai Kaneko)

110. (SBU) Tokushima Governor appointed to PSPC  
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Tokushima Prefecture Governor Kamon Iizumi was named the newest member of the Postal Services Privatization Committee (PSPC) on October 5. Iizumi replaced former Iwate Governor Hiroya Masuda, because Masuda became Minister for Internal Affairs and Communications (MIC) in the second Abe Cabinet and was reappointed to the current Fukuda cabinet.

Iizumi has a background in the Ministry of Home Affairs (later merged into MIC), which he joined after graduating from the Law Department of Tokyo University. He ran for Tokushima's governorship in 2003, and is currently serving his second term.

The PSPC is a five-member committee consisting of private sector experts, headed by Naoki Tanaka, President of Center for International Public Policy Studies. It is charged with guiding the privatization process, including reviewing applications for new insurance and banking products.

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The other members of the Committee are, Prof. Eiko Tsujiyama, Professor at Waseda University, Mr. Kazuhiko Toyama, CEO of Industrial Growth Platform, Inc. (former COO of Industrial Revitalization Corporation of Japan) and Prof. Shuya Nomura, Professor at Chuo Law School. (ECON: Ai Kaneko)

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TRADE  
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111. (SBU) AUSTR Cutler Discusses Economic Agenda with Japanese  
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Assistant U.S. Trade Representative for Japan, Korea, and APEC Affairs, Wendy Cutler, discussed with GOJ officials a range of topics on the economic agenda with Japan during her October 17-19 visit to Tokyo.

For more on her meetings, please see Tokyo 4943. Cutler also led Trade Forum talks on October 18, which will be reported separately.

For a copy of Cutler's October 19 speech at the Japan National

Press Club, entitled "U.S.-Japan Free Trade--Lessons from the U.S.-Korea FTA," please click here. (ECON: Nicholas Hill)

12. (SBU) Japan's Trade Surplus Grows  
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Japan's trade figures are out and its surplus with the United States has declined even as its overall surplus has surged. According to Ministry of Finance data released this week, Japan's trade surplus with the United States declined by 5.5 percent in the first half of 2007, while its surplus overall was up 46 percent.

According to the data, exports from the United States grew for the sixth consecutive half-year period, helped along by strong growth in demand for U.S. feed grains, including corn. Japan's trade surplus with the European Union was up 17 percent, spurred by the decline in the value of the yen against the Euro and British pound.

For more on the trade data from the Ministry of Finance's website (in English), please click here. Click here to access a Nikkei article that tells a similar story about Japan's growing trade surplus. (ECON: Nicholas Hill/Ryoko Nakano)

13. (SBU) Japan - Australia FTA Talks Resume in November  
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The last round of talks in August did not see much progress, but Australian and Japanese negotiators still plan to meet in November to see what can be accomplished in advancing their FTA agenda. A MOFA official told us, however, that no date has been set yet for the next round, which will likely take place in Canberra.

The official noted that Australia may think differently, but Japan still has no deadline to arrive at a deal. Another MOFA official we talked to was not optimistic about the prospects of concluding a deal with Australia, given the tough opposition put up by Japan's Agriculture Ministry and protectionist farm interests.

Meanwhile, the Japan - Australia Cooperation Committee, a business group in Japan of long standing, issued a joint statement with their Australian counterparts urging early progress on reaching a comprehensive agreement. According to the Yomiuri, the Australian business group attached priority to including the word "comprehensive" in the statement. An Australian Embassy source told us that the Japan Australia Business Cooperation Committee meets every year, alternating venues between the two countries. Attached is its joint statement issued in Tokyo. (ECON: Nicholas Hill)

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AGRICULTURE  
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14. (SBU) OECD Study: Japan's Pampered Farm Sector

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According to a recent OECD study (see link below), Japan ranks fifth among OECD members in the level of government support for farmers. The report credits the Japanese government for "gradually reducing" its role in setting prices, noting that it no longer sets prices for wheat, rice, and barley. Overall government support accounts for 53 percent of farm sector incomes.

Separately, an OECD team arrived in Japan last week to continue work on its regularly scheduled Japan country survey, which should be completed by next spring.

An OECD official told us that so far they have had a good reception by authorities. The report, as is OECD practice, will be the subject of review by the GOJ, which makes it more difficult to produce, but ultimately more influential. Click

here to view the report. (ECON: Nicholas Hill)

15. (SBU) Ag Ministry Considers Buying Extra Rice to Bolster Domestic Prices  
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According to a Nikkei article on October 24, Japan's Agriculture Ministry is considering buying up extra rice to prop up domestic prices, which have fallen about 10 in the past year. According to the article the Ministry has traditionally avoided using government purchases as a way of supporting prices.

Japan's current stockpile stands at about 770,000 tons. According to Nikkei, authorities are considering boosting the stockpiles to about one million tons. Sources we have talked to, including rice farmers, have lamented the drop in Japan's rice prices. It is more a structural than cyclical problem, as diets have changed and Japanese consume less rice.

In an article in the October 23 Daily Yomiuri, Junichi Maruyama points to two main reason for the recent falling rice prices: first, some farmers are exceeding government and farming organization production targets; and second, speculation that rice prices would fall has spurred buyers to delay purchases. This has suppressed demand even further. (ECON: Nicholas Hill)

16. (SBU) Japan's Beef Trade Restrictions: Politics over Science  
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USTR Special Envoy Richard Crowder led a delegation in Tokyo October 22 to underscore that Japan should adopt international, science-based standards in setting restrictions on U.S. beef imports. He told senior GOJ officials that he was on a five stop tour of the region and was conveying the same message. The United States expects its trading partners to abide by the decision of the World Animal Health Organization (OIE) which classified the United States as in a safe, or "controlled risk," category. Although this category means that U.S. beef from cows of any age can be traded, GOJ officials told Crowder that they cannot recommend this level of trade liberalization. The government is prepared to recommend to the Food Safety Commission (FSC) a liberalization to allow imports of beef from cows of 30 months or younger. For further information on the Crowder meetings, please contact us. (ECON: Nicholas Hill)

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IPR AND TELECOMMUNICATIONS  
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17. (SBU) Japan-Germany to Expand IPR Cooperation  
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Japan recently announced the launch of a pilot program with Germany to expand Patent processing cooperation from March 2008. This brings to four the number of countries with which Japan has agreements under the Patent Prosecution Highway (PPH), following the US, Korea, and the UK.

Under the PPH, an applicant may request that a patentable claim filed in one office also undergo accelerated examination in other participating offices. This is expected to reduce average examination periods from 26 months for first filings down to 2-3 months for second filings, and to reduce required supplemental documentation to as little as a single document.

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The Patent Prosecution Highway is expected not only to reduce the cost of filings but also reduce the burden and enhance the quality of examinations. Click here for information on the Japan-Germany pilot launch and click here for information on patent examination activities. (ECON: Scott Smith/Kaoru Nakata)

18. (SBU) Government Seeks to Open Up Cell-Phone-Related



## Businesses

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Japan wants to revitalize its telecommunications industry and break the grip of incumbent cell phone carriers. This is the aim of a Ministry of Communications (MIC) report released on October 23 on competition promotion programs for 2010, which outlines measures to open and promote competition in a number of related business fields. One priority is to make it easier for MVNOs (mobile virtual network operators) to lease cell phone networks from service providers. The Government also hopes to open competition in businesses such as: handsets, billing and personal authentication, and Web sites for Net-enabled phones.

MIC will draw up guidelines for cell phone service providers to ensure they will not stifle deregulation efforts. The guidelines are expected improve accountability and transparency, requiring service providers to disclose usage rules and charges for companies leasing networks.

The Ministry plans to revise accounting rules to stop cell phone service providers from tacking sales incentives onto connection fees. This will mean an end to 1 Yen phone sales but should rationalize service charges for retail as well as wholesale users.

More reasonable interconnection rates would reduce a significant barrier to prospective virtual network operators. (ECON: Scott Smith/Kaoru Nakata)

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## HEALTHCARE

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### 119. (SBU) Taking the Pulse of Healthcare IT in Japan

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Japan is currently looking to upgrade and integrate its Healthcare IT network to support electronic medical records and interface with Japan's national medical insurance system. A Senior Researcher from the Japan Medical Association (JMA) briefed ACCJ on the challenges and prospects for better utilizing IT in Japan's healthcare reform.

Early priority objectives in establishing the system will include increasing users while ensuring system security. The JMA researcher reassured the U.S. business audience that competition should be "promoted" as the system architecture is developed.

This is consistent with the ACCJ's position that the implementation of strategic healthcare IT throughout Japan should be an open and transparent process and allow for the full participation of non-Japanese firms. (FCS: John Fleming)

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## SPORTING NEWS

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### 120. (U) Back from the Precipice

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The baseball world -- and Japan's national TV broadcaster NHK -- can breathe more easily. The Boston Red Sox, behind the good, if not spectacular, pitching of Daisuke Matsuzaka and Hideki Okajima, beat the Cleveland Indians October 21 to advance to the World Series.

The Red Sox outscored the Indians 30-5 in winning three games in a row to win the series in seven. Matsuzaka and Okajima combined to give up only two runs in seven innings in the clincher, making NHK, the national network that carries MLB nationally in Japan, very happy.

Photos of the pair splashed all over Japan's media. NHK rebroadcast the game in prime time on Monday night, with a different focus from that in the U.S. There were lots of shots of Matsuzaka rubbing his eyebrow and Okajima staring out pensively from the bullpen -- but the network ran out of time to show the six run Red Sox explosion in the eighth inning. With the Indians out of the picture, the World Series promises to be a better media attraction in Japan. All eyes will be on the Red Sox pitching pair and the Colorado Rockies second baseman, Kaz Matsui, the former Yomiuri Giant. The scores will scarcely matter. (Econ: Nicholas Hill)

121. (U) With Popularity of MLB, Japanese Baseball Suffers?  
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A singles hitter in his thirties--in particular Ichiro Suzuki of the Seattle Mariners--is not worth a five-year \$100 million contract. A Japan Press Club official didn't seem comfortable with the statement and changed the subject.

The conversation moved on to the economics of Japanese professional baseball, and the impact of the recent exodus of Japanese stars to Major League Baseball (MLB) is having on the domestic game.

To judge from an article by Robert Whiting, who spoke at the Press Club, the news is not good. The Japanese professional league needs an overhaul if it is to survive financially. (Econ: Nicholas Hill)

122. (SBU) THIS WEEK'S CABLES

4992 CAPEC expresses Japan Post Express Mail Service fair competition concerns  
4971 Japan will demarche Bolivia at high level over Iran relations  
4970 Japan's strategy for the Third Committee  
4963 Japan still undecided about APDP, depends on PM Fukuda  
4968 Japan will decide UNIAAC vote at the last minute  
4953 Advocating for TIP victim identification procedures in Japan  
4951 Burma: Japanese assistance for police training  
4946 Tokyo Governor Ishihara urges Ambassador for progress on Yokota dual-use  
4943 AUSTR Cutler in Tokyo covers key issues on bilateral agenda  
4930 Japan plans outreach to MTCR non-partners, asks to coordinate  
4928 Japan's defense ministry may have purchased illegal night vision goggles  
4926 Ambassador and Defense Minister on def, alliance management  
4912 Foreign affairs experts on regional political and security architecture  
4905 Opposition DPJ struggles for consensus on OEF counterproposal  
4904 Japan demarche delivered MTCR non-papers, GOJ delegation identified  
4903 Government submits new OEF bill; MSDF to withdraw from Indian Ocean on November 2  
4901 Panel analyzes Fukuda, Japanese politics, regional disparities  
4890 Ambassador discusses Fukuda visit, North Korea, OEF, host nation support with MOFA Minister Komura  
4887 DPJ's Hatoyama explains DPJ views on elections, Diet, ISAF  
4884 Finance Minister Nukaga agrees to discuss host nation support with Ambassador  
4883 WIREC: Japan undecided, suggests Minister-level invitation

123. (U) This SENSITIVE BUT UNCLASSIFIED e-newsletter from U.S. Embassy Tokyo's Economic Section, with contributions from the consulates, is for internal USG use only. Please do not forward in whole or in part outside of the government. The Scope is edited this week by Charlotte Crouch (CrouchCA@state.gov) and Joy Progar (ProgarJ@state.gov). Please visit the Tokyo Econ Intranet webpage for back issues of



the Scope. Apologies, this option is only available to State users. Please contact Joy Progar if you are from a different agency and are interested in a back issue.

SCHIEFFER